BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2003-6-G – ORDER NO. 2003-489

AUGUST 8, 2003

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IN RE:	Annual Review of the Purchased Gas Adjustments (PGA) and Gas Purchasing)	ORDER ON PRUDENCE, PGA, AND RELATED	Mo
	Policies of South Carolina Pipeline)	MATTERS	
	Corporation.)		

This matter comes before the Public Service Commission of South Carolina (the Commission) on its annual review of the Purchased Gas Adjustments (PGA) and Gas Purchasing Policies of South Carolina Pipeline Corporation (SCPC, Pipeline or the Company).

I. INTRODUCTION

Commission Order No. 87-1122 provides that an annual review be conducted of SCPC's PGA and Gas Purchasing Policies. In this proceeding, the review period is April 2002 through December 2002. Petitions to Intervene were filed by the Consumer Advocate for the State of South Carolina (the Consumer Advocate), Chester, Lancaster, and York Natural Gas Authorities (the Authorities), and Nucor Steel (Nucor).

A hearing was held in this matter on May 15, 2003, at 10:30 a.m. in the offices of the Commission, with the Honorable Mignon Clyburn, Chair, presiding. SCPC was represented by Catherine D. Taylor, Esquire, and Mitchell Willoughby, Esquire. SCPC presented the testimony of Paul V. Fant, John S. Beier, Samuel L. Dozier, Michael P. Wingo, and Kevin Marsh (rebuttal only). The Consumer Advocate was represented by Elliott F. Elam, Jr., Esquire, and Hana Pokorna-Williamson, Esquire. The Authorities were represented by Paul Dillingham, Esquire.

Neither the Consumer Advocate nor the Authorities presented any witnesses. Nucor did not appear at the hearing. The Commission Staff (the Staff) was represented by F. David Butler, General Counsel. The Staff presented the testimony of Roy H. Barnette and Brent L. Sires.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. GAS PURCHASING POLICIES AND PRACTICES

As an initial matter, we find that SCPC's purchasing policies and practices were prudent during the review period. SCPC witness Wingo testified in detail about SCPC's recent gas purchasing policies and practices, concluding they were prudent. Staff witness Sires reached the same conclusion.

During the review period, SCPC maintained gas, storage, and transportation assets for its system during the period under review at levels that were prudent and reasonably met the reliability needs of the system. TR. at 78 and 180. SCPC continued to demonstrate that it places a high level of importance on securing reliable gas supplies and on making prudent decisions in purchasing its gas supplies. TR. at 180. No supply problems were noted on the Company's system during the review period. <u>Id.</u> In addition, SCPC continues to exhibit its capabilities to secure gas supplies in a prudent manner and at reasonable costs. TR. at 181. We, therefore, find that SCPC's gas purchasing policies and practices were prudent during the period of April 2002 through December 2002.

B. ADHERENCE TO TARIFF

We also find that during the review period SCPC properly adhered to the tariff provisions relating to recovery of its gas costs. There was no dispute as to whether gas costs were properly recovered during the review period. SCPC witness Beier described the procedure the Company

followed for gas cost recovery, concluding that calculations were made in compliance with the approved tariff and Commission directives. TR. at 102-103. Staff witness Barnette presented the Commission Staff's audit of the Company's cost of gas and stated that the amounts shown fairly represent the Company's costs incurred for the period April 2002 through December 2002. TR. at 169. Accordingly, we find that for the period of April 2002 through December 2002, SCPC's gas costs were accurately stated, SCPC's gas cost recovery was calculated in compliance with Commission orders and the approved gas tariff, and the monthly cost of gas rates resulted in the precise recovery of actual gas costs incurred by the Company.

C. INDUSTRIAL SALES PROGRAM-RIDER

Next, we find that the Industrial Sales Program Rider (ISP-R) continued to produce benefits for SCPC's firm customers and that the program should be continued. As SCPC witness Dozier testified, the ISP-R allows SCPC to assign delivered gas costs to industrial customers at prices that are competitive with alternative fuel prices and enables SCPC to make interruptible sales that otherwise might not be made. TR. at 37-38. Staff witness Sires confirmed that the ISP-R is needed for SCPC to effectively compete with alternate fuels in the industrial market. TR. at 188. The ISP-R promotes more efficient use of SCPC's facilities, helps to recover a portion of SCPC's fixed costs through industrial sales, allows SCPC to exert purchasing power in interruptible gas markets so that natural gas is obtained at better terms and prices, and provides additional flexibility and reliability to SCPC's system. TR. at 38-39. For these reasons, the ISP-R should be continued without modification.

We deny the Consumer Advocate's Motion to modify the ISP-R to require the Company to assign gas to its interruptible customers with the highest cost with which the Company can

still make the gas sale. According to the Consumer Advocate, nothing would change with the individual customer, in that the only change would be the cost of gas assigned to the customer. Pipeline argues that granting this Motion would increase the total cost of operating the system and that the impact on Pipeline would be a reduction in margins and the inability to meet the Company's revenue requirement. Pipeline states that it would have to shift costs. However, Pipeline also alleges that there is not enough evidence in the record of this case to support this Motion. We frankly believe that we just simply do not have enough evidence in the record on this particular matter to properly consider the Consumer Advocate's Motion. We therefore deny it.

D. 20,000 DEKATHERMS PER DAY REQUIREMENT

By Commission order, SCPC is required to assign to the weighted average cost of gas (WACOG) 20,000 dekatherms of the least expensive daily delivered gas volume entering SCPC's system. TR. at 186. During the period under review, this requirement caused SCPC to lose approximately \$2,167,046 in approved margins and caused its sale-for-resale customers to lose approximately \$243,693. TR. at 104-105.

In this proceeding, no evidence was presented that would warrant modifying the 20,000 dekatherms per day requirement. Rather, Staff witness Sires testified that this level of lowest cost gas entering the WACOG was acceptable and that the Commission Staff recommended that it be continued. TR. at 186-187. No other witness or party took exception to Staff's recommendation. Accordingly, SCPC should continue to assign 20,000 dekatherms of the least expensive daily delivered gas volume to the WACOG.

E. PILOT HEDGING PROGRAM

We also find that SCPC's pilot hedging program was managed consistent with Commission orders during the period under review, has provided benefits to firm customers in the past, and should be continued at this time (see Beier and Sires testimony). The primary objectives of the program are three-fold: (1) during times when low prices persist, to lock in low prices which have a high probability of increasing over the long run; (2) during periods of neutral prices, through the use of dollar cost averaging, to achieve an average market price over the long run but with a lower volatility than spot prices; (3) during periods of rising prices or periods of uncertainty, to protect against extreme high prices. TR. at 107-108. The Commission approved the pilot hedging program in 1995, initially allowing SCPC to hedge up to 30% of purchases for firm customers. The Commission allowed subsequent increases in volumes that may be hedged. Since 1997, SCPC has been allowed to hedge 75% of estimated purchases for firm customers. For the period under review, the result of the program was that the hedging program subtracted \$3,595,273 from the Weighted Average Cost of Gas (WACOG) TR. at 109. Since inception, the hedging program added \$18,907,198 to the WACOG through December 31, 2002. During the three months ending March 31, 2003, the hedging program subtracted \$14,350,263 from the cost of gas. As the program stood at the end of March, the addition to the cost of gas since inception of the program was \$4,556,935. In addition, Pipeline can determine that in light of present market conditions, the open positions currently held would lower the cost of gas by an additional \$632,710 to \$3,924,225. TR. 109-110.

It appears to us that the hedging program continues to have value as a tool in the purchase of gas in that its overall effect is to reduce volatility in gas prices. Accordingly, we hold that the hedging program shall be continued as currently approved by this Commission.

F. MISCELLANEOUS MATTERS

1. Put Options

Included in the WACOG for this review period are costs related to put option contracts entered in the spring of 2002. According to the Company's testimony, these put options took advantage of an up-tick in NYMEX prices to offset the possible effect on the WACOG of multimonth term guarantee contracts that included pricing negotiated to reflect current market conditions. Some of the put contracts expired at a time when they were "in the money", and the resulting proceeds were credited against the cost of the puts. However, the market did not return to the lower price levels seen earlier in the year, and not all of the puts were profitable. In fact, the net cost of the put contracts to WACOG customers during the review period was \$1.3 million. TR. at 104. However, the total net result of the purchase of put options increased the total Company cost of gas by \$2,889,856. This amount is not considered by the Company to be part of the hedging program. TR. at 169. The put options were part of the "physical purchases" of gas under fixed pricing arrangements. TR. at 249. The portion of the cost of gas made up by the puts not included in the \$1.3 million and not in the review period is attached to gas in storage at this time.

The Staff has stated that, although this Commission has not approved the use of the put options, the Company ought to "continue to have the flexibility to have a daily presence in the market and have the opportunity to react on a daily basis as the natural gas market unfolds. This

flexibility should include the option to purchase supply under fixed pricing arrangements." TR. at 183. The Company concurs with this position. TR. at 246. Sires further notes that there are many purchasing decisions that the Company makes daily that are not specifically addressed in the Company's approved PGA or prior Commission Orders. TR at 184. Staff does ultimately state, however, that the Company should "seek Commission approval of a procedure outlining the methodology for this purchasing strategy." <u>Id.</u>

In its Brief in this case, the Consumer Advocate stated that, because there were no reporting requirements already established on the performance of the put options, there is no guarantee that the Company would have credited ratepayers had there been any benefits to the purchase of the put options. As noted by the Consumer Advocate, the Commission-approved hedging program involved a detailed examination of the methodologies used by the Company, but that no such methodologies were used by the Company in this case.

We must state that we do have some concerns about the use of put options, especially since the use of those options cost the WACOG customers \$1.3 million during the review period. Further, there is another \$1.6 million attached to gas in storage that will eventually hit the WACOG. Accordingly, we believe that we should hold the issue of cost recovery for the put options during this review period in abeyance until such time as a generic proceeding can be held concerning put options and other financial devices employed by South Carolina Pipeline Corporation in its purchase of gas. We think that such a proceeding will allow us to further investigate puts and other devices and decide whether we should establish procedures and/or methodologies for their use. Unlike the usual generic proceeding before the Commission, we hold that the Company shall present testimony first in the proceeding, and shall bear the burden

of proof on the matter. The hearing shall be scheduled by the Staff after consulting the Commission's future calendar.

2. Motion on Administrative Notice

South Carolina Pipeline Corporation filed a post-hearing Motion for this Commission to take administrative notice of certain evidence in this Commission's files. Questions were raised during the hearing about the possible quantification of a benefit to fixed costs that the ISP-R program provides. This subject arose during questioning by Company witness Beier by Chairman Clyburn and by Elliott Elam, the Acting Consumer Advocate. The witness was not able to provide the requested quantification. Subsequent to the hearing, the Company filed a Motion stating that this Commission requires Pipeline to file quarterly reports reflecting, among other things, the Company's revenues and expenses concerning its industrial gas operations, and requesting that the Commission take administrative notice of the June 17, 2003 report, the implication being that the report could answer the quantification question. Pipeline argued that its Motion was supported by 26 S.C. Code Ann. Regs. 103-870(C)(1976) and by certain case law.

The Consumer Advocate filed an objection to the Motion, stating that because the Motion was made only after the hearing and attempts to introduce new evidence into the record, the Consumer Advocate is unable to cross-examine witnesses regarding how the reports were put together, including what assumptions were made on cost allocation. The Consumer Advocate asserts that this inability to conduct such an examination of this evidence violates due process rights, and should not be permitted.

The Company replied to the Consumer Advocate's document, stating that the Consumer Advocate was aware that SCPC submits reports to the Commission on a quarterly basis, and is also aware that these reports contain financial information related to the Company. Further, the Company asserts that the Consumer Advocate opened the door to use of the reports through his cross-examination, thus, no due process or cross-examination rights are violated.

We deny the Motion. We find that the Company's Motion to include the report was not timely filed. The Company was aware during the hearing that the report referenced by its witness was in the Commission's files. The Company could have, and should have, requested during the hearing that the Commission take notice of the report. Pipeline argued in its Motion that 26 S.C. Code Regs. 103-870(C) (1976) supported admitting the evidence following the hearing. However, that regulation provides that judicial notice may be taken of judicially cognizable facts or of generally recognized technical or scientific facts within the agency's specialized knowledge. Further, the regulation provides that parties of record are to be notified of the material to be noticed either before or during the hearing or by reference in preliminary reports. Clearly, the Company did not notify the other parties of record of the request for judicial notice either before or during the hearing. Thus, 26 S.C. Code Regs. 103-870(C) (1976) has not been complied with and does not support the Company's post-hearing Motion. We believe that principles of fairness dictate that the Consumer Advocate should have the ability to conduct cross-examination on such a document. Since no cross-examination would be available with the post-hearing admission of this report, we deny the Company's Motion.

IT IS THEREFORE ORDERED THAT:

- 1. SCPC's gas purchasing policies and practices during the period April 2002 through December 2002 are found to be prudent.
- 2. SCPC is found to have properly adhered to the gas cost recovery provisions of its gas tariff during the period April 2002 through December 2002.
- 3. The requirement that SCPC assign to the WACOG 20,000 dekatherms of the least expensive daily delivered gas volume shall be continued.
- 4. The ISP-R shall be continued without modification. The Consumer Advocate's Motion to modify the ISP-R is denied.
- 5. SCPC is found to have managed the hedging program during the period under review consistent with Commission orders, and the hedging program shall be continued at 75% of estimated gas purchases for firm customers at the present time.
- 6. We hold in abeyance any decision on the recovery of the use of put options until such time as a generic proceeding can be held concerning SCPC's utilization of puts and other financial devices.
- 7. The Company's Motion that the Commission take administrative notice of certain evidence in our files is denied.

8. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Mignon L. Clyburn, Chairman

ATTEST:

Gary E. Walsh, Executive Director

(SEAL)